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SUBJECT: DRAFT NATIONAL TRADE ESTIMATE REPORT

REF: STATE 88447

The following is Embassy Ankara's input for the National Trade Estimate Report for Turkey (text has also been emailed per instructions in reftel):

TRADE SUMMARY

The U.S. goods trade surplus with Turkey was $4.7 billion in January-August 2008, an increase of 291 percent from $1.2 billion in the same period of 2007. U.S. goods exports in the first eight months of 2008 were $7.5 billion, up 75.9 percent from the previous year. Corresponding U.S. imports from Turkey were $2.9 billion, down 6.9 percent. Turkey is currently the 31st largest export market for U.S. goods.

According to Turkish Treasury data, the stock of U.S. foreign direct investment (FDI) in Turkey was $6.3 billion in 2007 (latest data available), up from $2.1 billion in 2006. U.S. FDI in Turkey is concentrated largely in the banking, manufacturing, and wholesale trade sectors.

IMPORT POLICIES

Tariffs and Quantitative Restrictions

Turkey applies the EU's common external customs tariff to third-country nonagricultural imports (including from the United States) and imposes no duty on nonagricultural items from EU and European Free Trade Association (EFTA) countries.

Turkey maintains high tariff rates (an average 28.3 percent Most Favored Nation rate) on many food and agricultural product imports, which is estimated to cost U.S. importers over $500 million per year in lost trade. Duties on fresh fruits range from 15.4 percent to 145.8 percent. Tariffs on processed fruit, fruit juice, and vegetables range between 19.5 percent and 130 percent. The Turkish government also levies high duties, excise taxes and other domestic charges on imported alcoholic beverages that increase wholesale prices by more than 200 percent.

Importers of rice, dried beans, wheat, barley, rye, oats, corn, and hazelnuts must comply with a reference price system, which sets the minimum prices on which duties are assessed, rather than using customs declarations or market prices. This reference system costs importers between an estimated $10 and $25 million per year.

Import Licenses and Other Restrictions

Import licenses are required for products that need after-sales service (e.g., photocopiers, advanced data processing equipment, and diesel generators), distilled spirits, and agricultural products. Lack of transparency in Turkey's import licensing system results in costly delays, demurrage charges, de facto bans and other uncertainties. The Turkish government routinely stops issuing import licenses for domestically produced food (such as pulses, nuts, and dried fruits) during the harvest season to eliminate competition and keep prices high. For some crops, like wheat, the government simply does not issue licenses and therefore maintains control over the level of imports through quotas. In addition, documentation requirements for all food imports are inconsistent, non-transparent, and do not follow standard international practices. This often results in shipments being held up at port over onerous certification requirements that have changed or are unclear. The estimated cost

of this barrier is between $100 and $500 million.

In November 2005, the United States brought a dispute against Turkey in the World Trade Organization (WTO) arguing that, inter alia, Turkey's tariff-rate quota (TRQ) scheme for rice, which contains an onerous domestic purchase requirement, and its refusal to issue import licenses for rice outside the TRQ, are inconsistent with Turkey's WTO obligations. In September, 2007, the dispute settlement panel agreed with the United States that Turkey's failure to grant licenses to import rice and its operation of a discretionary import licensing system for rice are in breach of Turkey's market access obligations under the WTO Agreement on Agriculture. The panel also agreed with the United States that Turkey's domestic purchase requirement, under which Turkey required importers of rice to purchase large quantities of domestic rice in order to import rice at preferential tariff rates, is in breach of the national treatment provisions of the WTO. The reasonable period of time for Turkey to bring itself into compliance with the WTO's rulings and recommendations expired at the end of April
¶2008. Turkey and the United States are currently engaged in discussions to explore the possibility of entering into a Memorandum of Understanding that would set out commitments by Turkey on its import practices affecting U.S. rice. It is estimated that this agreement, once finalized, will result in $25 to $100 million in increased trade.

For some products, notably for meat and poultry, the Turkish government simply does not issue import licenses, thereby creating a de facto ban on imports of these products. Turkey has not allowed meat imports from any country since 1996 and has not established any public health

requirements for the entry of meat. Outbreaks of Bovine Spongiform Encephalopathy (BSE) and foot and mouth disease (FMD) in Europe strengthened Turkey's resolve to keep poultry and meat products out of its market. As a result of ongoing discussions, a protocol permitting the import of live breeding cattle from the United States was agreed to in July 2007. Turkey continues to require inspection and approval of all foreign poultry processing facilities at the expense of Turkish importers, a condition that has the effect of preventing poultry imports. Turkey maintains that the ban on meat imports relates to valid health concerns, but if imports were to be allowed it is estimated that the benefit to U.S. exporters would be worth $100 to $500 million.

Despite liberalization of the spirits and tobacco markets - including a completed privatization of the state-owned alcoholic beverage company and the state-owned tobacco company, as well as privatization of imports of wine and alcoholic beverages - increases in consumption have been inhibited by inordinately high tariffs (85 percent to 100 percent) and special consumption taxes (275 percent), along with the value added-tax (VAT). In 2006, legislation was introduced to reduce the number of control certificates required to import distilled spirits from two to one, but full jurisdiction could not be transferred to just one entity, so the legislation was never enacted. Instead, the Turkish government has focused on improving the efficiency and speed of the process so as not to put an undue burden on importers. This topic was discussed at all recent Trade and Investment Framework Agreement (TIFA) Council meetings.

STANDARDS, TESTING, LABELING, AND CERTIFICATION

The Turkish government has a poor track record of notifying WTO Members of proposed or final technical regulations and phytosanitary requirements. Most changes in regulations become effective immediately upon publication with little or no notification to trading partners. This often results in significant disruptions in trade. Furthermore, laws and regulations do not appear to be implemented or enforced immediately or consistently at every port, creating unpredictability and making it difficult for the exporter and the importer to comply. The inconsistent requirements from port to port occasionally result in long delays or denial of entry for imported products, and the estimated cost of this barrier is between $10 and $25 million per year. The United States Government has raised the issue with the Turkish government on several occasions.

Importers report difficulty in obtaining information on sanitary and phytosanitary (SPS) requirements. The United States Government has raised the issue of transparency with the Turkish government on multiple occasions, including informal discussions at the July 2007 TIFA Council meeting, the October 2007 WTO Sanitary and Phytosanitary Committee meeting, and during Turkey's November 2007 Trade Policy Review by the WTO. In January 2008, Turkey notified the WTO of an SPS measure related to phytosanitary requirements for seed potatoes -

the first Turkish notification since 2004.

U.S. companies have reported that products bearing the EU certificate of conformity (CE mark), particularly medical devices, have been detained by Turkish customs authorities for inspection. In some cases, U.S. products apparently have been subjected to additional tests, despite their CE marks. For importation of distilled spirits, Turkish customs requires that between two and four bottles per consignment be submitted for unspecified analyses, raising the cost of importing.

Turkey does not have any regulations related to biotechnology in force and the fourth draft of a National Biosafety Law is being reviewed by office of the Prime Ministry. The previous draft would have effectively halted U.S. exports of soybeans, soy and corn-based products and affected cotton exports to Turkey. The current draft has not been made public. The total value of U.S. transgenic crop exports to Turkey was over $1 billion in 2007, all of which could be endangered depending upon how any future law is written. The United States Government and private industry have been actively raising awareness among Turkish regulators as to the benefits and safety of biotech crops.

GOVERNMENT PROCUREMENT

Turkey is not a signatory to the WTO Agreement on Government Procurement; however, it is an observer to the WTO Committee on Government Procurement.

Turkey's public tender law established an independent board to oversee public tenders. Foreign companies can participate in state tenders that are above an established threshold. The law provides a price preference of up to 15 percent for domestic bidders, which is not available if they form a joint venture with foreign bidders. Turkey has expanded the definition of domestic bidder to include foreign-owned corporate entities established under Turkish law. Although Turkey's laws require competitive bidding procedures for tenders, U.S. companies have complained that

they can be lengthy and overly complicated.

Military procurement generally includes an offset requirement in the tender specifications. The offset guidelines were recently modified to encourage foreign direct investment and technology transfer.

EXPORT SUBSIDIES

Turkey employs a number of incentives to promote exports, although programs have been scaled back in recent years to comply with EU directives and WTO commitments. Export subsidies ranging from 10 percent to 20 percent of export values are granted to 16 agricultural or processed agricultural product categories in the form of tax credits and debt forgiveness programs, and are paid for by taxes on exports of primary products such as hazelnuts and leather. The Turkish Grain Board generally sells domestic wheat at world prices (which are well below domestic prices) to Turkish flour and pasta manufacturers in quantities based upon their

exports of flour and pasta.

Similarly, the Turkish Sugar Law allows a certain amount of domestic sugar ("C quota") to be sold at world prices for utilization in products that will be exported. The current price for this C quota sugar is $390/MT; while the normal domestic selling price is $1,370/MT. Exporters also do not pay import duties on the amount of sugar imported for use in their exported products. The impact of this subsidy on U.S. exports to Turkey is estimated at less than 10 million dollars.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Turkey's intellectual property rights regime (IPR) has improved markedly in recent years. As a result of notable progress on copyright enforcement, seizures of pirated goods, and imposition of deterrent penalties by the courts, Turkey was lowered to the Special 301 Watch list in 2008, from the Priority Watch List in 2007. In 2008, the Ministry of Culture published a new circular, reminding all government agencies of the requirement to use licensed software, which the software industry welcomed. A new patent law is also under consideration by Parliament.

In spite of this progress, the pharmaceutical sector continues to be concerned about protection for confidential test data against unfair commercial use. Turkey provides six years of data exclusivity from the date a product is first approved in the Customs Union Zone which, due to lengthy approval times in Turkey, may mean that data exclusivity for a product approved elsewhere in Europe has already expired or is near expiration by the time the product can be brought to market in Turkey.

Trademark holders contend that there is widespread and often sophisticated counterfeiting of their marks in Turkey, especially in apparel, film, cosmetics, detergent, and other products.

SERVICES BARRIERS

Telecommunications Services

In November 2005, 55 percent of the government-owned Turk Telecom was sold to a foreign investor. Although Turkey has committed to ending Turk Telecom's exclusive rights on fixed telephony services, its delay in issuing implementing regulations has resulted in a delay in the establishment of alternative fixed line suppliers. The Telecommunications Authority (TK)

has been actively issuing the regulations needed to promote a competitive market, but it still lacks adequate authority to provide effective enforcement. The Turkish Parliament passed an Electronic Communication Law which would have given greater authority to TK, but it was vetoed by the President, requiring certain changes. The revised law is under consideration by Parliament, and passage is expected by the end of the year. The new law aims to harmonize Turkey's communication legislation with the EU. It will also reduce the Ministry of Transport and Communications' (MOTC) influence over TK's decision making. This year, TK took some important steps to support market

liberalization, such as the decision to start implementing mobile number portability (MNP) as of November 2008. This will also help encourage more companies to bid for the 3G license tender to be held at the end of November 2008.

Applicable licensing regulations and tender announcements are published on the TK website.

Cellular telephone and paging services are open to competition.

Other Services Barriers

There are restrictions on establishment in financial services, the petroleum sector, broadcasting, and maritime transportation (see Investment Barriers section). Turkish citizenship is required to practice as an accountant or certified public accountant, or to represent clients in Turkish courts. Legislation awaiting final approval by Parliament would permit foreign doctors to work in Turkey.

INVESTMENT BARRIERS

The United States-Turkey Bilateral Investment Treaty entered into force in May 1990. Almost all areas open to investment by the Turkish private sector are fully open to foreign participation without screening or prior approval, although establishment in the financial and petroleum sectors requires special permission. Foreign equity ownership is limited to 25 percent in broadcasting and 49 percent in maritime and air transportation. Parliament is considering draft legislation easing restrictions on foreign ownership in the media sector.

Once investors have committed to the Turkish market, they have sometimes found their investments undermined by legislative action, such as the imposition of production limits. Turkish law calls for a liberalized energy market in which private firms are able to develop projects with a license obtained from the Energy Market Regulatory Authority, an independent regulatory body. The state electricity utility has been unbundled into power generation, transmission, distribution, and trading companies, and after years of delays, the first four electricity distribution regions were privatized in 2008. The Turkish government plans to finalize privatization of distribution facilities and start privatization of generation facilities by the end of 2009. This ambitious schedule may be delayed by limited access to credit caused by the global financial situation. Liberalization in the natural gas sector also has faced delays. The state pipeline company, BOTAS, will remain dominant in gas importation, but legislation requires a phased transfer of 80 percent of its gas purchase contracts to the private sector by ¶2009. Except for a small scale contract transfer tender in 2005, BOTAS has failed to reach its targets and still has an 86% share in

the gas market. The Turkish government now realizes its goals for reducing BOTAS' market share are not realistic. The government will soon introduce an amendment to the Natural Gas Market Law that will liberalize the importation of gas into Turkey but will drop provisions to

downsize BOTAS. Natural gas distribution in cities is dominated by the private sector. The only exceptions to this are the Ankara and Istanbul distribution networks, where the local administrations hold the distribution license. In 2008, a deal was reached to privatize Ankara's pipeline network, Baskent Gaz, but the financing for the deal fell through as a result of the global financial crisis and the future of the project is unclear.

As the result of a 1997 court decision, the Turkish government blocked full repatriation of profits by oil companies under Article 116 of the 1954 Petroleum Law, which protected foreign investors from the impact of lira depreciation. Affected companies have challenged the 1997 decision but the judgments in almost all such lawsuits have been against the claimant companies. Oil and gas companies also have difficulty getting visas for workers to enter Turkey and complain that license fees and taxes are too high in the sector. A new petroleum law that seeks to provide greater investment incentives and protections still awaits passage in the parliament.

Obtaining work permits for professional or highly skilled foreign workers is a pervasive problem among both foreign and Turkish employers. The process is time-consuming and requires extensive documentation, the adjudication process is lengthy (often exceeding the time for which the permit is requested), and the chances of approval are low.

Foreign ownership of real estate in Turkey has long been a contentious issue. In early 2008, the Constitutional Court issued two decisions that suspended portions of the Foreign Direct Investment Law and the Title Deed Law, which had allowed foreign individuals and companies to purchase land. In response, the Turkish government passed new legislation to permit these purchases again, but imposed an upper limit on the amount of land that can be owned by foreign individuals - no foreign individual may own more than 2.5 acres and all foreign individuals together can own no more than 10 percent of the land in any given development zone. As information on the amount of land currently held by foreigners in any development zone is not readily available, this may in the future cause problems and legal challenges for individual investors seeking to purchase land in Turkey. There are no limits on the amount of land that can be owned by foreign companies with a legal presence in Turkey, so long as the land is being used in accordance with their business activities.

OTHER BARRIERS

Corruption

Turkey has ratified the OECD anti-bribery convention and passed implementing legislation that makes bribery of foreign and domestic officials illegal and not tax deductible. Despite this, many foreign firms doing business in Turkey perceive corruption to be a problem, particularly by some government officials and politicians. The judicial system is also perceived to be susceptible to external influence and to be somewhat biased against outsiders.

Energy

Turkey's decision to cancel 46 contracted power projects in 2001 led to a number of arbitration cases against the government, with the end result that most companies were compensated. However, this action and the uncertainty it generated, combined with GOT controlled prices despite rising fuel costs, delayed private investments in the sector from 2001-2008. At the same time, demand for electricity increased substantially over this period, as the Turkish economy experienced record growth rates. In order to address the supply gap problem which Turkey is likely to face as of 2009, the government passed an energy security law in 2007 and introduced a number of incentives to facilitate investment in the energy sector. Turkey also implemented an "automatic pricing mechanism" in 2008, according to which electricity prices are revised three times a year, based on changes in the FX rate, oil prices, and the consumer price index, and gas prices are adjusted monthly.

Turkey passed its long-awaited Nuclear Power Law in 2008, and conducted a tender in September 2008 to build a nuclear plant. Several international companies, including U.S. firms, expressed interest in the tender. However the government turned down the companies' request for a delay in the bidding deadline, and as a result only one Russian consortium submitted a bid. The government has not yet indicated the final disposition of this bid or the manner in which bids for future projects will be considered. A new law will need to be passed before another nuclear power plant tender can be conducted.

Taxes

Taxation of all cola drinks (raised in 2002 to 47.5 percent under Turkey's "Special Consumption Tax") discourages investment by major U.S. cola producers. Turkey assesses a special consumption tax of 27 percent to 50 percent on all motor vehicles based on engine size, which has a disproportionate effect on U.S. automobiles.

Corporate Governance

A recent OECD report stated that Turkey's overall corporate governance outlook is positive because the authorities have already adopted, or are introducing, high quality corporate governance standards (including audit standards) and because transparency has improved significantly. The report cautions, however, that it is important for Turkey to improve further in the areas of control and disclosure of related party transactions and self-dealing, the protection of minority shareholders, and the role of the board in overseeing not only management but also controlling shareholders.

Pharmaceuticals
Aside from their intellectual property concerns detailed above, the pharmaceutical industry's sales have been affected by government price controls and an awkward and burdensome reimbursement system. In 2008, Turkey implemented changes in its discounting scheme that increased the cost borne by pharmaceutical manufacturers. U.S. research-based

pharmaceutical firms are also concerned about achieving transparent and equitable treatment in upcoming reforms of the government's health care and pension system.

WILSON